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In the Supreme Court of the United States

OCTOBER TERM, 1957

PANAMA CANAL CO., PETITIONER

v.

GRACE LINE, INC., ET AL.

GRACE LINE, INC., ET AL., CROSS-PETITIONER

v.

PANAMA CANAL CO.

MEMORANDUM FOR THE PANAMA CANAL COMPANY IN ANSWER TO THE REBUTTAL BRIEF FOR GRACE LINE, ET AL.

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No. 252

GRACE LINE, INC., ET AL., CROSS-PETITIONER

v.

PANAMA CANAL CO.

MEMORANDUM FOR THE PANAMA CANAL COMPANY IN ANSWER TO THE REBUTTAL BRIEF FOR GRACE LINE, ET AL.

Most of the points in the Rebuttal Brief for the Respondents Grace Line, Inc., et al., filed after the argument, are matters which have been dealt with in our Main and Reply Briefs, and in the oral argument. Respondents' first two points, however, contain new arguments which require further reply.

I

Point I of the Rebuttal Brief reopens an argument with respect to the effect of the Comptroller General's

Audit Report which we had believed settled by a concession in respondents' brief in opposition to our petition for certiorari in No. 251. In that petition we stated that the grant of summary judgment by the Court of Appeals was understandable only on the hypothesis that that court had accepted respondents' theory, asserted in their complaint (par. 10, R. 6) and again in their motion for summary judgment (par. 3, R. 13), that the accounting determinations of the General Accounting Office are final and conclusive on the Panama Canal Company (Petition in No. 251, pp. 37–41). Indeed, we set forth this issue as the second question presented by our petition:

> 2. Whether Sections 105 and 106 of the Government Corporation Control Act impose upon a Government corporation the ministerial duty to comply with the conclusions regarding *accounting, cost allocation, and statutory interpretation* reached by the Comptroller General in his commercial-type audit report. [Petition in No. 251, p. 2; emphasis added.]

The petition thus presented the question of whether the Comptroller General's reports were binding as a matter of law or fact.

Respondents' Brief in Opposition in No. 251 charged that this second question in the petition constituted a "false issue" and made the formal statement (p. 2) that "The Court of Appeals did not hold and the plaintiffs did not maintain or even intimate that the GAO interpretation of the statute as requiring the prescription of tolls without regard to the losses of the collateral activities was binding on defendant".

As the result of this concession, we did not brief the question of the effect of the Comptroller General's Audit Report—whether legal or factual—in our Main Brief (cf. pp. 3, fn. 4, 89–90). Respondents' Main Brief (pp. 58–59) again charged the petitioner with having attempted to raise a false issue in the petition for a writ of certiorari in No. 251. It did not warn that we might have misconceived the scope of the concession.

Now, in their Rebuttal Brief, respondents for the first time make the statement (p. 2) that if "the summary judgment granted by the Court of Appeals is affirmed * * * [they] will then argue to the District Court that the accounts stated by the General Accounting Office of *the Canal operation only*, i. e., as distinguished from the business activities, are binding on the defendant, not because the Court of Appeals so held, but because, in our opinion, the Government Corporation Control Act so requires, once the question of the interpretation of Section 412 (b) has been settled". In other words, respondents now belatedly explain that their concession was limited to the Comptroller General's statutory interpretations, not to his accounting determinations and cost allocations.

If that explanation had been made in respondents' Main Brief, petitioner would have been enabled to address itself to this issue in its Reply Brief. As the matter now stands, the problem has not been fully presented to this Court simply because respondents,

though put on notice, did not explain their true position to petitioner or the Court.[1]

Moreover, respondents' present pronouncement that the accounts stated by the Comptroller General are binding on petitioner is in direct conflict with respondents' complaint in their brief in opposition to certiorari in No. 251 (pp. 2–3) that the Comptroller General could not reach any definite conclusions because petitioner had refused to give him the necessary information. Again, at pp. 58–59 of their Main Brief, respondents take the position that the significance of the Comptroller General's Report is evidentiary, *i. e.*, not binding.[2]

Having thus thwarted proper review in this Court of the question raised in the petition in No. 251 as to the effect of the Comptroller General's report upon petitioner, respondents should not be permitted (if

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[1] In our Petition for a Writ of Certiorari in No. 251, pp. 37–41, 39, fn. 71, we pointed out, without full development of the point, that the Comptroller General's Audit Reports under the Government Corporation Control Act are not, and never were intended to be, binding statements of account under Section 304 of the Budget and Accounting Act of 1921, 42 Stat. 24, 31 U. S. C. 74.

[2] Actually, even the evidentiary value of the Comptroller General's reports is extremely limited. The 1954 Report concedes that its figures are merely tentative (R. 41–42). The Comptroller General's Report for 1956 (H. Doc. 210, 85th Cong., 1st Sess.) used a different method of computation designed to produce "a somewhat more accurate result" but warns that even these results "should not be regarded as exact" (p. 17). See also 1956 Report, p. 18, note c, admitting that the 1954 Report erroneously had allocated to the business activities 75% of the Administrative and General Corporate Expense (cf. R. 54, note c) and that 58.5% was the proper figure.

the occasion should arise) to press these very issues, or some of them, in the District Court in connection with the formulation of a possible judgment and in possible enforcement proceedings.[3]

II.

In Point II of their Rebuttal Brief (pp. 3–4), respondents charge that petitioner's "'ambiguous bookkeeping' has misled its counsel into making incorrect statements in its reply brief". We submit that, on the contrary, our statements are correct, and that it is respondents' argument which discloses inadequacies. We point out the errors in some detail because of the serious charge that petitioner's Reply Brief contains incorrect statements of fact.

Respondents' arguments are that in 1949 petitioner's business activities had earned a profit of $1,173,168 after administrative expenses; that, contrary to our statement in the Reply Brief (p. 13), these activities had failed to earn a similar profit in 1954 but had not even earned their administrative

[3] Respondents accuse us of grasping at straws by stressing their Prayer No. 4 (R. 8, 11) "Enjoining and restraining the defendant in the prescription of tolls from using accounts less favorable to the plaintiffs and their class than those determined by the General Accounting Office" (Brief in Opposition in No. 251, p. 3; Respondents' Main Brief, p. 58, footnote; Rebuttal Brief, pp. 2–3). The fact is that paragraph 4 appears to be a part of the motion for summary judgment which has been granted (cf. R. 257, 258) and petitioner is quite naturally concerned about the consequences of its inclusion in a final judgment. Respondents have not offered to stipulate unambiguously that a judgment to be entered on the motion for summary judgment would not include a clause corresponding to their Prayer No. 4.

expenses; and, finally, that the estimated loss of petitioner's business activities after administrative expenses for the fiscal year 1958 amounts to $3,250,450.

1. In point of time, respondents start out with the proposition that in 1949 petitioner's business activities earned a profit *after* administrative expenses in the amount of $1,173,168. This figure has apparently been obtained by adding to the net profit of the Panama Railroad Company, (*i. e.*, $160,355[4]) the profit of $1,006,959.04 of the business operations of the former Panama Canal Agency, as distinguished from the Panama Railroad Company.[5] It appears, however, that this profit of $1,006,959.04 does not take into account a number of expense items which would now be considered administrative and general expense.[6] Hence, it cannot be called, without qualification, profit after administrative expenses. Moreover, it is significant that these business activities would have suffered a loss of $125,962.76 if they had been charged with interest on the capital investment.[7] The inability of the supporting operations to earn the interest on the capital investment thus is not a new phenomenon caused (as respondents charge) by petitioner's inflation of administrative expenses and ambiguous bookkeeping. In any event, respondents' figure of $1,173,168 does not constitute a clear profit after administrative expenses.

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[4] Petitioner's Main Brief, p. 11, fn. 17; President's Budget for the Fiscal Year 1951, p. 158.

[5] Annual Report of the Governor of Panama Canal, 1949, pp. 28, 97, 104.

[6] *Ibid.*, p. 104, Table 23.

[7] *Ibid.*, pp. 28, 104, Table 23.

2. Respondents also say that the tables at p. 13 of our Reply Brief show that the supporting activities failed to earn their share of administrative expenses. Respondents do not amplify this statement, and it is quite unfounded.

The schedule at p. 13 of the Reply Brief shows an operating income of the Allied Maritime Operations of $1,518,020 and of the Supporting Service Operations of $2,549,197, totalling $4,067,217. The Comptroller General's report for 1954 took the position that the business activities consisting of Allied Maritime Operations and the Supporting Service Operations, having a combined operating income of $4,067,217, should be charged with 75% of the Administrative and Other General Expenses, *i. e.*, with $3,832,363 (R. 53 and 54, note c). Thus, on the basis of the Comptroller General's allocation ratio for 1954, the business activities had a profit after administrative and general expenses of $234,854, and not a loss as claimed by respondents.[8]

The 1956 Report of the Comptroller General, concedes, however, that the 75% allocation of the Administrative and Other General Expenses to the business activities was erroneous and that the proper allocation

[8] Respondents' statement that the Supporting Service Operations had a loss can be understood only on the basis that respondents, misunderstanding the Comptroller General's computations, seek to allocate 75% of the Administrative and Other General Expenses to the operating income of the Supporting Service Operations alone, without taking account of the fact that this 75% allocation refers to *all* business activities, which include both the Allied Maritime Operations and the Supporting Service Operations.

ratio for the entire period from 1952–1956 should have been 41.5% to the Canal operations and 58.5% to the supporting business activities.[9] Using these corrected figures, the Operating Income of the business activities, amounting to $4,067,217, should have been charged with only 58.5%, or $2,900,262.69, of the Administrative and Other General Expenses, leaving a profit of $1,166,954.31, *i. e.*, a sum almost identical with respondents' 1949 figure of $1,173,168 which, as we have shown, *supra*, p. 6), contains some administrative expenses.

3. Respondents likewise claim that a deficit of the business activities in the amount of $3,250,450 is expected for the fiscal year ending June 30, 1958. The fact is that, if the figures are properly computed, the business activities presumably will break even. In any event, the loss of operating income and the increase of administrative expenses is not petitioner's fault, but is the direct consequence of congressional action.

As already noted, petitioner's business activities fall into two groups, the "allied maritime operations" and the "supporting operations".[10] The 1958 budget estimates the income from the former activities at $1,131,500,[11] which is $400,000 less than in 1954.[12] The decrease in operating income of the supporting service operations is far more serious. That figure has

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[9] H. Doc. 210, 85th Cong., 1st Sess., p. 18, note c.

[10] R. 179, Reply Brief, p. 13; Respondents' Rebuttal Brief, p. 4, footnote.

[11] H. Doc. 16, 85th Cong., 1st Sess., p. 618, Schedule B–1.

[12] Cf. Reply Brief, p. 13.

shrunk from $2,549,197 in 1954 (Reply Brief, p. 13) and $2,389,987 in 1956 [13] to an estimate of $886,800 in 1958.[14] The reasons for this change, however, are beyond petitioner's control.

One of them is the $531,600 deficit of the Panama Railroad [15] which petitioner seeks to abandon but is compelled to continue in operation by virtue of a congressional directive.[16] In addition, Art. XII of the 1955 Treaty with Panama (6 U. S. T. 2273, 2288–89), which limits the right to make purchases in the commissary stores to United States citizens and persons actually residing in the Canal Zone, has cut the gross receipt of the commissaries from nearly $26,000,000 in 1956 to an expected $13,760,000 in 1958 (*i. e.*, nearly in half), and has reduced their operating profit by $579,000 from $779,106 in 1956 to an expected $200,000 in 1958.[17] For similar reasons, the profit of the "supply operations" has shrunk by nearly $250,000.[18] But for these congressional and treaty requirements the operating income of the supporting service operations would amount to approximately $2,300,000, *i. e.*, not much less than the 1954 figure [19] which, as we have seen, compares favorably with the one for 1949.

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[13] H. Doc. 16, 85th Cong., 1st Sess., p. 619, Schedule B–2.

[14] *Ibid.*

[15] *Ibid.*

[16] Petitioner's Main Brief, p. 53.

[17] H. Doc. 16, 85th Cong., 1st Sess., p. 619, Schedule B–2. See also the pertinent comments in the Audit Report of the Comptroller General for 1956, H. Doc. 210, 85th Cong., 1st Sess., pp. 13–14.

[18] *Ibid.*

[19] *Supra*, p. 7; Reply Brief, p. 13; R. 179.

Respondents now claim that the operating profit of the Allied Maritime Operations ($1,131,500) and of the Supporting Service Operations ($886,800), totalling $2,018,300, should be charged with 75% of the General Corporate Charges or Administrative Expenses (an item which they say amounts to $7,015,000), and thus they compute a deficit of $3,250,450. Respondents' figure of $7,015,000 has been taken from a schedule entitled "Statement of Sources and Application of Funds".[20] According to petitioner's "Consolidated Statement of Income and Expense", the item "Other General Corporate Charges", after direct assessment of assignable charges, amounts to $6,163,400, *i. e.*, nearly $1,000,000 less than respondents' figures.[21]

Furthermore, we have shown (*supra*, pp. 7–8) that the supporting business operations for 1956 cannot be charged properly with 75% of the administrative expenses. The Comptroller General's Audit Report for 1956 pointed out that 58.5% was the correct figure for the fiscal years from 1952–1956. Even that ratio, however, is no longer accurate in view of the notable reduction in the scope of the supporting service activities. In 1956, their gross income amounted to

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[20] H. Doc. 16, 85th Cong., 1st Sess., p. 615.

[21] H. Doc. 16, 85th Cong., 1st Sess., p. 616. This figure is only slightly higher than the $5,843,319 actually incurred in 1956. It is about $1,200,000 in excess of the 1954 figure (R. 179). This increase has been caused by the general rise in costs and, in part, by the obligations incurred under the Treaty with Panama, cf. Comptroller General's Audit Reports for 1954, 1955 and 1956. H. Doc. 160, 84th Cong., 1st Sess., pp. 21–23; H. Doc. 465, 84th Cong., 2d Sess., p. 14; H. Doc. 210, 85th Cong., 2d Sess., p. 18.

$41,629,185, *i. e.*, a little more than that of the Canal operations. The 1958 estimate of the gross income of the service operations has been reduced to $28,763,400, while that of the Canal has risen slightly.[22] This shrinkage in the role of the service activities requires a recomputation of the percentage of the administrative expenses allocable to the supporting business activities. It is probable that this recomputation will result in so substantial a reduction of the 58.5% figure used by the Comptroller General in 1956 that the supporting business activities will not show a loss for 1958.[23]

Respectfully submitted,

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APRIL 1958.

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[22] H. Doc. 16, 85th Cong., 1st Sess., pp. 618–619, Schedules B–1 and B–2.

[23] We wish to stress that we have made the computations in Part II of this memorandum merely in order to show that, if respondents' view that allocation is required is accepted, the supporting business activities do not show a loss after general corporate expenses. This, however, is not to be regarded as a concession that petitioner has the duty of making such an allocation of its corporate overhead (cf. Main Brief, pp. 80–82).

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